DEPARTMENT OF STATE REVENUE

18-20200127R.ODR
18-20200418R.ODR

Final Order Denying Refund: 18-20200127R; 18-20200418R
Financial Institutions Tax
For Tax Years 2018-2019

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Final Order Denying Refund.

HOLDING

Company is a Financial Institution and therefore cannot claim the Adjusted Gross Income Tax research and expense credit; even if Company could claim the research and expense credit it did not provide sufficient evidence to do so. Therefore, the Department correctly denied Company's refund request.

ISSUE

I. Financial Institutions Tax–Refund.

Authority: IC § 6-5.5-9-4; IC § 6-3.1-4-1; IC § 6-8.1-5-1; *IDOPCP, Inc. v. Comm'r*, 503 U.S. 79 (1992); *Indiana Dep't of State Rev. v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Indiana Dep't of Revenue v. Miller Brewing Co.*, 975 N.E.2d 800 (Ind. 2012); 45 IAC 15-3-2; Financial Institution Tax Booklet, 2019 Form FIT-20, p. 13.

Taxpayer protests its refund denial.

STATEMENT OF FACTS

Taxpayer is a business that has subsidiaries in Indiana and is incorporated outside Indiana. Taxpayer has been filing in Indiana as a financial institution since 2015. Prior to 2015 Taxpayer was included in a combined return filed by Corporation. Taxpayer filed an Indiana Financial Institutions Tax ("FIT") return for 2018 and 2019 claiming a refund based on Research and Expense Credits taken on Line 35b. The Indiana Department of Revenue ("Department") denied the refund determining that Taxpayer could not take the research and expense credit as a Financial Institution. Taxpayer protested the refund denial; an administrative hearing was held and this Final Order Denying Refund results. Further facts will be supplied as necessary.

I. Financial Institutions Tax–Refund.

DISCUSSION

Taxpayer protests the Department's denial of its refund claim. This decision will first look to whether a taxpayer subject to FIT can take the research and expense credit ("REC"), then the Department will determine if the projects would qualify for the REC.

"[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to an agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014). Therefore, when the statute is plain and unambiguous there is no need to delve into the legislative history of the statute.

> Our settled procedure of statutory construction begins with a determination as to **whether the legislature has spoken clearly and unambiguously on the point in question.** If so, our task is relatively simple: we need not "delve into legislative intent" but must give effect to "the plain and ordinary meaning of the language."

Indiana Dep't of Revenue v. Miller Brewing Co., 975 N.E.2d 800, 803 (Ind. 2012).

(**Emphasis added**) (Internal citation omitted).

Taxpayer filed a FIT return for the years at issue claiming the research and expense tax credit. The Department notes that, "An income tax [credit] is a matter of legislative grace and that the burden of clearly showing the right to the claimed [credit] is on the taxpayer." *IDOPCP, Inc. v. Comm'r*, 503 U.S. 79, 84 (1992). Moreover, where such a credit is claimed, "the party claiming the same must show a case, by sufficient evidence, which is clearly within the **exact letter of the law**." *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 100-01 (Ind. Ct. App. 1974) (**emphasis added**). Thus, Taxpayer's claims against any tax must be supported by records necessary to substantiate a claimed credit.

A. Whether a taxpayer subject to FIT can take the research and expense credit.

Taxpayer does not protest whether it is subject to FIT and concedes that it properly filed as a financial institution for 2018 and 2019. Following a restructuring in 2017 Taxpayer established three new subsidiaries beginning in 2017. Taxpayer's protest letter states, "Pursuant to Ind. Code § 6-5.5-1-18 and Ind. Code § 6-5.5-6-1, the three new entities mentioned [], as subsidiaries of [Taxpayer], a Financial Institution, were required to file a combined Indiana FIT-20 return. [Taxpayer] is the only entity in the Indiana return that is actually a Financial Institution." Taxpayer claims it is the subsidiaries conducting the qualifying research activity. Taxpayer claimed the research and expense credit on line 35b on the FIT-20. This line is labeled as "Other Tax Liability Credits Available to Financial Institutions". Financial Institution Tax Booklet, 2019 Form FIT-20, p. 13.

To determine who can take the research and expense credit the Department turns to IC § 6-3.1-4-1 which defines "Research expense tax credit" to mean "credit provided under this chapter against any tax otherwise due and payable under IC 6-3." In addition, the same statute defines "Taxpayer" to mean "individual, corporation, limited liability company, a limited liability partnership, a trust, or partnership that has any tax liability under **IC 6-3 [adjusted gross income tax]**." *Id.*

Taxpayer states that it is a financial institution and filed a FIT-20 for the years at issue; therefore, Taxpayer and its affiliates are subject to tax under IC § 6-5.5. The Department notes that IC adjusted gross income tax, established under IC § 6-3, and financial institutions tax, established under IC § 6-5.5, are separate and distinct taxes. Also, IC § 6-5.5-9-4 states that "(a) A taxpayer who is subject to taxation under this article for a taxable year or part of a taxable year is not, for that taxable year or part of a taxable year, subject to the income taxes imposed by IC 6-3." Thus, under Indiana law it is implausible and contrary to statutory interpretation for a financial institution to be taxable under IC 6-3. Because only a taxpayer subject to tax under IC § 6-3 can take the research and expense credit, and Taxpayer cannot be subject to tax under IC § 6-3, it logically flows that Taxpayer cannot take the research and expense credit.

Taxpayer claims in its protest that it is allowed to take the REC despite not being directly subject to tax under IC § 6-3. Taxpayer cites to IC § 6-3.1-4-2(a) which states: "A taxpayer who incurs Indiana qualified research and expense in a particular tax year is entitled to a research expense tax credit for the taxable year." Taxpayer further states that, "[A] qualifying taxpayer with Indiana qualified research expense is entitled to take the Indiana Research Expense Credit. . . .The financial institution tax imposition under Ind. Code § 6-5.5-9-4(a) states 'A taxpayer who is subject to taxation under this article . . . is not . . . subject to the income taxes imposed by IC 6-3.' Since [Taxpayer] is a corporation, it is first subject to tax under IC 6-3. After being subjected to this tax, it is then tested to determine whether the financial intuitions tax will apply. If financial institutions were not subject to IC 6-3, then they would never be subject to Ind. Code § 6-5.5."

Taxpayer's argument is tenuous at best. The process of determining if a taxpayer is subject to adjusted gross income tax under IC § 6-3 or is subject to financial institutions tax under IC § 6-5.5 does not automatically subject it to IC § 6-3 rules. Rather, if the financial institution taxpayer is subject to FIT under IC § 6-5.5, then IC § 6-3 does not apply. The Department is unconvinced that Taxpayer's argument withstands review.

As stated above, if the statutory language is unambiguous, "we need not 'delve into legislative intent' but must give effect to 'the plain and ordinary meaning of the language.'" *Miller Brewing Co.*, at 803 (Ind. 2012). IC § 6-3.1-4-1 only allows the research and expense credit against any tax liability under IC § 6-3. IC § 6-5.5-9-4(a) explicitly and plainly states that a taxpayer subject to FIT is not subject to tax under IC § 6-3. The Department cannot think of a clearer way to say that a Taxpayer subject to FIT cannot be subject to tax under IC § 6-3 and therefore cannot take the research and expense credit. If the legislature intended to allow a financial institution to take the REC it would have granted it under IC § 6-5.5. Rather, the legislature determined that a taxpayer subject to FIT cannot be subject to tax under IC § 6-3. To allow a taxpayer subject to FIT to take a tax credit that is

exclusively for taxes under IC § 6-3 would be illogical and directly in contradiction to the clear and unambiguous language in the statutes.

In its protest, Taxpayer also claimed that it called the Department's customer service line and was informed by one of our Customer Service Representatives that they could take the REC as an FIT. It is important to note that 45 IAC 15-3-2(e) states:

> Oral opinions or advice will not be binding upon the department. However, taxpayers may inquire as to whether or not the department will make a ruling or determination based on the facts presented by the taxpayer. If the taxpayer wishes a ruling by the department, the formal request must be in writing. A taxpayer may also orally receive technical assistance from the department in preparation of returns. However this advice is advisory only and is not binding in the latter examination of returns.
>
> Based upon general inquiries and correspondence, the department often issues written letters of advice. Such letters are advisory in nature only and merely technical assistance tools for the taxpayer. Strictly informational type letters are not to be considered rulings by the department and will not be binding.

Thus, the Department cannot be bound by the oral advice given during said phone call. The Department would also like to point out that Taxpayer's Power of Attorney reached out to the Department's policy division asking the same question. The Policy Division gave an informal informational type of email in which they said a taxpayer subject to FIT cannot take the research and expense credit, for similar reasons provided above. Thus, Taxpayer has been informed by the Department that the credit cannot be taken by a financial institution and based on the regulation oral advice cannot be binding on the Department. Therefore, the Department is not bound by the advice over the phone.

Thus, based on the information above a taxpayer subject to FIT cannot take the research and expense tax credit. Taxpayer's position that an entity subject to financial institution tax may claim an adjusted gross income tax credit is incorrect.

B. Whether Taxpayer could take the research and expense credit if it was not an FIT.

As established above, the REC is not available to financial institutions under Indiana law. However, even if the REC was available to Taxpayer, it failed to meet the requirements to claim the credit. The second issue at protest is whether Taxpayer's activities meet the definition of research and expense in order to claim the credit allowed for under IC § 6-3.1-4-1 and I.R.C. § 41. I.R.C. § 41(d) sets out a four-pronged test for verifying qualified research activities. First, the research must have qualified as a business deduction under I.R.C. § 174. I.R.C. § 41(d)(1)(A). Second, the research must be undertaken to discover information "which is technological in nature." I.R.C. § 41(d)(1)(B)(i). Third, the taxpayer must intend to use the information to develop a new or improved business component. I.R.C. § 41(d)(1)(B)(ii). Finally, the taxpayer must pursue a "process of experimentation" during substantially all of the research. I.R.C. § 41(d)(1)(C). All four tests must be satisfied to qualify for the credit.

In its protest, Taxpayer laid out the projects it claims qualify for REC. These projects consist of internal use software. As such, the I.R.C. § 41 has a subsection dedicated to the standard for internal use software. I.R.C. § 41(d)(4)(E) "the term 'qualified research' shall not include any of the following: . . . **Computer Software.**--Except to the extent provided in regulations, and research with respect to computer software which is developed by (or for the benefit of) the taxpayer primarily for internal use by the taxpayer, other than for use in (i) an activity which constitutes quailed research, or (ii) a production process with respect to which the requirements of paragraph (1) are met." Treas. Reg. 1.41-4(c) states:

> (6) Internal use software–(i) General rule. Research with respect to software that is developed by (or for the benefit of) the taxpayer primarily for the taxpayer's internal use is eligible for the research credit only if–
> (A) The research with respect to the software satisfies the requirements of section 41(d)(1);
> (B) The research with respect to the software is not otherwise excluded under section 41(d)(4) (other than section 41(d)(4)(E)); and
> (C) The software satisfies the high threshold of innovation test of paragraph (c)(6)(vii) of this section.
> (ii) Inapplicability of the high threshold of innovation test. This paragraph (c)(6) does not apply to the following:
> (A) Software developed by (or for the benefit of) the taxpayer primarily for internal use by the taxpayer for use in an activity that constitutes qualified research (other than the development of the internal use software itself);
> (B) Software developed by (or for the benefit of) the taxpayer primarily for internal use by the taxpayer for

use in a production process to which the requirements of section 41(d)(1) are met; and

(C) A new or improved package of software and hardware developed together by the taxpayer as a single product (or to the costs to modify an acquired software and hardware package), of which the software is an integral part, that is used directly by the taxpayer in providing services in its trade or business. In these cases, eligibility for the research credit is to be determined by examining the combined hardware-software product as a single product.

(iii) Software developed primarily for internal use– (A) In general. Except as otherwise provided in paragraph (c)(6)(vi) of this section, software is developed by (or for the benefit of) the taxpayer primarily for the taxpayer's internal use if the software is developed for use in general and administrative functions that facilitate or support the conduct of the taxpayer's trade or business. Software that the taxpayer develops primarily for a related party's internal use will be considered internal use software. A related party is any corporation, trade or business, or other person that is treated as a single taxpayer with the taxpayer pursuant to section 41(f).

(B) General and administrative functions. General and administrative functions are:

(1) Financial management. Financial management functions are functions that involve the financial management of the taxpayer and the supporting recordkeeping. Financial management functions include, but are not limited to, functions such as accounts payable, accounts receivable, inventory management, budgeting, cash management, cost accounting, disbursements, economic analysis and forecasting, financial reporting, finance, fixed asset accounting, general ledger bookkeeping, internal audit, management accounting, risk management, strategic business planning, and tax.

(2) Human resources management. Human resources management functions are functions that manage the taxpayer's workforce. Human resources management functions include, but are not limited to, functions such as recruiting, hiring, training, assigning personnel, and maintaining personnel records, payroll, and benefits.

(3) Support services. Support services are other functions that support the day- to-day operations of the taxpayer. Support services include, but are not limited to, functions such as data processing, facility services (for example, grounds keeping, housekeeping, janitorial, and logistics), graphic services, marketing, legal services, government compliance services, printing and publication services, and security services (for example, video surveillance and physical asset protection from fire and theft).

Taxpayer provided a sample of projects, job titles, and project narrative memos for five projects that they believe meet the four-part test. Taxpayer's sample included internal-use software. The Department reviewed the sample and noted that Taxpayer failed to take into consideration the higher threshold that internal-use software must meet in order for those expenses to be treated as qualifying activities. However, the Department need not delve into those details because Taxpayer's documentation did not sufficiently show that it has qualifying activities. The source documentation failed to trace all employee annual salaries (some including temporary interns) to the projects, explain those employees' job functions, and most importantly tie the employees to the projects.

It is Taxpayer's statutory obligation to maintain and produce records sufficient to verify the credits which it claims pursuant to IC § 6-3.1-4-1 and IC § 6-8.1-5-4. This is especially true in the case of the RECs for which the I.R.C. imposes stringent and detailed parameters and which - if Taxpayer seeks to obtain the benefit of those credits - Taxpayer is required to meet. Treas. Reg. § 1.41-4(d) (TD 8930) and (TD9104).

Indiana case law speaks to the issue of the documentation required to establish entitlement to credits such as that sought by Taxpayers. "[A]n income tax deduction is a matter of legislative grace and that the burden of clearly showing the right to the claimed deduction is on the taxpayer." *IDOPCP, Inc. v. Comm'r*, 503 U.S. 79, 84 (1992). Moreover, where such a credit is claimed, "the party claiming the same must show a case, by sufficient evidence, which is clearly within the **exact letter of the law**." *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d at 100-01. (**Emphasis added**). Thus, every taxpayer's claims against any tax must be supported by records necessary to substantiate the claimed credits and those records are required to be "kept" "before or during the early stages of the research project." Thus, even if Taxpayer, a financial institution, could claim the research and expense credit under Indiana law, it has not provided sufficient documentation to show that it is entitled to the credit.

In conclusion, Taxpayer is subject to financial institutions tax under IC § 6-5.5 and may not claim the adjusted gross income tax credit under IC § 6-3.1-4-1. Taxpayer may not rely on advice it received over the telephone by a Department employee, as provided by 45 IAC 15-3-2(e). Even if Taxpayer were subject to Indiana adjusted gross income tax against which the claimed credit is applied, which it is not, it has not established that it qualifies for the credit under the provisions of IC § 6-3.1-4-1 and I.R.C. § 41.

FINDING

Taxpayer's protest is denied.

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